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WLF URGES OFFICIALS TO PROBE INSURANCE BROKER BUSINESS PRACTICES

In the interests of consumers and the values of fair and open competition, the Washington Legal Foundation (WLF) today called on the attorneys general and insurance departments of New York and California to investigate — and consider taking action on — two potentially damaging practices engaged in by some in the insurance brokerage industry.

WLF, a national, non-partisan, non-profit public interest law and policy center, urged the states to probe conflicts of interest caused by placement service agreements (PSAs) and “leveraging” in the insurance brokerage industry.

The use of PSAs encourages brokers to steer customers to insurers that will profit the broker, but not necessarily benefit that customer, said WLF Chairman and General Counsel Daniel J. Popeo. “This is a troubling trend in the insurance brokerage industry,” Popeo said. “Insurance brokers are paid to advocate for their customers, not themselves.”

PSAs compromise a broker’s duty to the client’s best interests by encouraging brokers to refer business only to companies that pay them handsome contingency fees, WLF’s Popeo said. As a result, customers run the risk of paying more for coverage they do not need, and receiving less in terms of overall policy benefits.

The U.S. Securities and Exchange Commission has already uncovered widespread abuse of similar agreements in the mutual fund industry. And respected voices are calling attention to the troubles with PSAs in the insurance industry.

A J.P. Morgan report on Jan. 13, 2004, warned that PSAs “can create the appearance of factors other than the best interests of the insured being contemplated.” It also said that these agreements are likely to be scrutinized in 2004.

Until recently, these conflicts of interest have lurked unseen, Popeo said. Often clients have not been appropriately informed of the agreements. However, even open disclosure of PSAs may not entirely solve the conflict of interest because clients would have to question whether the brokers’ recommendations were prompted by integrity or influence.

Insurance brokers have already been criticized for a similar second practice, called “leveraging” or “tying.” This practice coerces insurance companies into handing over their reinsurance needs in exchange for future referrals for their primary insurance business. The National Consumers League called for an investigation into leveraging last summer and, with

increased scrutiny of PSAs, it is ripe for abuse, if not carefully watched. WLF's Popeo said, "We join the Consumers League in its concern that the public's interest be protected with regards to these practices."

In letters sent today, the Foundation urged New York Attorney General Eliot Spitzer, New York Superintendent of Insurance Gregory V. Serio, California Attorney General Bill Lockyer and California Insurance Commissioner John Garamendi to investigate PSAs and consider appropriate action to address these conflicts of interest.

WLF Chairman Popeo said this is part of the Foundation's ongoing efforts to promote business practices that advance the free market and ensure that the interests of investors and consumers are strongly protected.

"These agreements create an unavoidable conflict of interest for the insurance broker and distort the marketplace for insurance," he said. "They harm businesses, they undermine confidence in the insurance industry, and they should be investigated."

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